Summary of Testimony of
Chairman James J. Hoecker
Federal Energy Regulatory Commission
before the
Committee on Government Reform
United States House of Representatives
September 21, 2000

Over two decades ago, Congress and the Commission began encouraging the development of competition in the natural gas industry and then the electric industry. As a result of these efforts, today's natural gas commodity markets are competitive. This competition has produced substantial benefits for consumers. The recent increases in natural gas prices should not weaken support for competitive market policies. The price increases have already prompted more drilling, and these efforts will increase the supply of natural gas and help restore a better balance of supply and demand.

Competition in bulk power markets is not yet as developed as competition in natural gas markets. Competitive wholesale electricity prices in California this summer have been particularly volatile. A number of possible causes for the sharp price increases are commonly cited. Among these are rising demand for electricity, not enough new generating facilities, unusually hot weather over a large region, inefficient market rules and market structures, and, according to some observers, collusion or other anticompetitive behavior by generators.

In response to events in California and other parts of the country, the Commission directed its staff to investigate conditions in bulk power markets and report its findings to the Commission by November 1, 2000. More recently, I have asked staff to accelerate its investigation as it relates to California and Western markets. In addition, the Commission has opened a formal investigation into California's wholesale markets, which will allow the Commission to take steps within its jurisdiction to address identified market problems.

Going forward, the Commission's overall goal is to help meet the Nation's needs for reliable and reasonably priced energy by establishing a fair, open and efficient regulatory foundation for competition in energy markets. Congress can help by enacting electricity legislation. This legislation should provide for comparable and open access to all transmission facilities, regional transmission organizations, mandatory reliability rules, and tools for remedying market power.

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Mr. Chairman and Members of the Subcommittee:

Good morning. I am James J. Hoecker, Chairman of the Federal Energy Regulatory Commission (Commission). Thank you for inviting me to participate in today's hearing on the cost of energy, which is a matter of great importance to American consumers and the growing digital economy.

The Commission has long been promoting competition in the key markets it regulates – wholesale electric energy and natural gas markets – to foster a more efficient energy industry and to bring energy consumers reliable energy at the lowest reasonable cost. Our goal has been to rely on competition where competition can work and bring benefits to consumers in the long-run. However, we continue to regulate rates and terms of access for essential transportation and transmission services, monitor the wholesale markets we regulate and, where necessary, apply traditional or other appropriate regulation to curb market power and ensure consumer protection.

Today, my testimony will first describe the scope of the Commission's general regulatory authorities. I will describe briefly the state of the wholesale natural gas and electricity markets. I will focus primarily on recent electric price volatility and electric competition issues, particularly recent events in California, and what we are doing about them. Finally, I will briefly discuss legislative reforms that are necessary to ensure competition and consumer protection in the electric energy markets.

I. The Commission's Regulatory Responsibilities

The Commission is a five-member independent regulatory agency, which succeeded to the regulatory responsibilities of the Federal Power Commission in 1977. The Commission's responsibilities include the licensing of non-Federal hydroelectric facilities, the certification of natural gas pipelines, regulating the rates of natural gas pipelines and pipelines transporting crude oil and oil products, and regulating the rates and other aspects of electric utility activities. (See Appendix A for summary of key FERC responsibilities.)

Hydropower is the oldest area of Commission jurisdiction. The Commission's predecessor began Federal regulation of non-Federal hydroelectric generation in 1920, authorizing the construction of projects in interstate commerce and overseeing their operation and safety. The Commission now regulates 2,000 dams that generate over five percent of all electric power in the United States.

Since 1935, the Commission has regulated certain electric utility activities under the Federal Power Act (FPA). Under FPA Sections 205 and 206, the Commission oversees the rates, terms and conditions of sales for resale of electric energy and transmission service in interstate commerce by public utilities. The Commission must ensure that those rates, terms and conditions are just and reasonable, and not unduly discriminatory or preferential. Under FPA Section 203, the Commission reviews mergers and other asset transfers involving public utilities. The utilities regulated under FPA sections 203, 205 and 206 are primarily investor-owned utilities; government-owned utilities (such as TVA, the federal power marketing agencies, and municipal utilities) and most cooperatively-owned utilities are not subject to the Commission's regulation, with certain exceptions.

The Commission may not regulate retail sales or local distribution of electricity. These are matters left to the States by the FPA. Nor does the Commission have a role in authorizing the construction of new generation facilities (other than non-Federal hydroelectric facilities) or transmission facilities. These too are State or local responsibilities.

The Commission's role in the natural gas industry is largely defined by the Natural Gas Act of 1938 (NGA). Under the NGA, the Commission regulates the construction of new natural gas pipelines and related facilities and oversees the rates, terms and conditions of sales for resale and transportation of natural gas in interstate commerce. Pipeline siting and construction is authorized by the Commission if found to be required by the public convenience and necessity. As with hydropower licensing, the Commission's actions on pipeline projects typically require consideration of factors under the National Environmental Policy Act, the Endangered Species Act, the Fish and Wildlife Coordination Act, the Coastal Zone Management Act and other such legislation. The wellhead price of natural gas, which the Commission previously regulated, was gradually deregulated by Congress beginning with the Natural Gas Policy Act of 1978 (NGPA). All wellhead price controls on natural gas ended on January 1, 1993. Regulation of retail sales and local distribution of natural gas are matters left to the States.

Finally, the Interstate Commerce Act gives the Commission jurisdiction over the rates, terms and conditions of transportation services provided by interstate oil pipelines. The Commission has no authority over the construction of new oil pipelines, or over other aspects of the industry such as production, refining or wholesale or retail sales of oil.

II. The Development of Competition in the Natural Gas and Electric Industries

Congress gave the Commission its rate regulation responsibilities with the fundamental objective of protecting consumers from abuses of market power. Historically, the Commission relied on cost-based rates to meet this goal. However, the success of pro-competition policies in other infrastructure industries (e.g., trucking, railroads, airlines, long-distance telephone) demonstrated that economic efficiency and consumer interests sometimes could be better served by effective competition than by traditional cost-of-service regulation. As a result, Congress and the Commission began encouraging the development of competition in the natural gas industry and later in the electric industry.

A. Natural Gas

In 1978, the NGPA began the process of decontrolling natural gas commodity prices. In the face of a critical supply shortage, Congress opted to encourage market forces to play a more significant role in determining supply, demand, and price of natural gas. In 1985, because the Commission believed that pipeline transportation problems were preventing consumers from seeing the benefits of wellhead decontrol, the Commission issued Order No. 436. This was the first order to institute open access and non-discriminatory transportation across a major energy delivery infrastructure. Open access pipelines had to allow gas buyers to purchase gas directly from production area sellers and to obtain transportation services on the same non-discriminatory basis as the pipeline companies served themselves.

In 1992, the Commission completed its open access transportation initiative by requiring interstate pipelines to exit the natural gas sales, or "merchant," business. This effectively separated the transportation of gas from the sale of gas and removed both the opportunity and incentive to discriminate among shippers or sources of supply. The Commission also required pipelines to permit firm shippers to resell their unused pipeline capacity rights (called "capacity release"), creating a valuable and efficient secondary transportation market. Congress ended all wellhead price controls as of January 1, 1993.

During all of these changes, the Commission further supported the development of competition and worked to ensure the adequacy of the transportation infrastructure by authorizing proposed construction of new natural gas pipelines in appropriate circumstances. From 1995 to 1999, for example, the Commission approved over 8,000 miles of pipeline projects. Since 1997, the Commission has authorized the addition of almost 17 billion cubic feet per day (Bcf/day) of new delivery capability to the pipeline network. These facilities represent an investment of over $7.5 billion in natural gas transportation infrastructure. In light of probable demand growth for natural gas, the Commission continues to receive new proposals for pipeline development. I would note that the modern pipeline certificate process is characterized by heightened landowner concerns, environmental issues, and debates over regional needs for pipeline additions. Thus, the Commission carefully considers these factors in making its determination of whether a given proposal is in the public convenience and necessity.

B. Electricity

Growth of competition in today's electricity markets began with the implementation of the Public Utility Regulatory Policies Act of 1978 (PURPA), which encouraged development of renewable energy sources and cogeneration. This law opened the door to competition by facilitating the first significant entry of non-utilities into the generation business. Non-utility generators soon showed that they could build and operate power plants as well as, or better than, the existing vertically-integrated electric utilities. The PURPA experience made clear that there was no "natural monopoly" for electricity generation. Soon, other independent power producers began to build power plants even without the help of PURPA, as traditional utilities became more risk averse. In addition, independent power marketers, which did not own physical facilities, entered the electric industry and began selling power at wholesale. The Commission recognized that these new entrants to the wholesale electricity markets lacked market power and began authorizing them to sell wholesale power at market-based rates. Since then, the Commission has authorized such rates for hundreds of wholesale sellers shown to lack market power. The presence in the market of these generators, which were not built only to serve a specific "load" or group of customers, expanded the size and importance of the wholesale or "bulk" power market.

In the Energy Policy Act of 1992 (EPAct), Congress endorsed expanded transmission access and competition in wholesale power markets. It enhanced the Commission's authority to require utilities to provide transmission services on a case-by-case basis for others. Non-discriminatory transmission access is key to competition because it allows buyers and sellers to reach one another over the interstate transmission highway. EPAct also authorized exemptions from certain legal restrictions under the Public Utility Holding Company Act for generators selling exclusively at wholesale. This legislation, as implemented by the Commission, helped to expand the trading opportunities of wholesale buyers and sellers.

In 1996, the Commission adopted Order No. 888, requiring open (i.e., available to all wholesale customers) and non-discriminatory access to the transmission facilities of public utilities. Open access dramatically enhanced the ability of wholesale buyers and sellers to transact with each other, giving market participants many more trading opportunities. This is a strategy similar to the one pursued by the Commission for natural gas pipelines.

Finally, having found that certain structural attributes of the industry still inhibited competition, the Commission adopted Order No. 2000 last year. This order addressed remaining industry problems by encouraging transmission-owning utilities to form regional transmission organizations, or "RTOs." An RTO is an electric transmission system operator that is completely independent from power market participants and is responsible for providing reliable, efficient and non-discriminatory transmission service in an entire region. If properly constituted and truly independent, RTOs can help address and eliminate remaining obstacles to competition and make the markets more efficient, for the benefit of electricity consumers in all states. RTOs will promote wholesale competition and, where states allow it, they will facilitate retail competition. However, because the FPA does not mention RTOs, some question the Commission's authority to mandate their formation and the Commission has therefore tried to promote RTO formation through voluntary utility efforts. We will soon know whether this voluntary approach will be successful.

III. State of Wholesale Markets Today

A. Natural Gas Markets

Today, natural gas commodity markets are competitive. There is truly a continental natural gas market in North America. Reserve prospects are very promising. However, production, transportation, and distribution capabilities will be tested by the significant annual demand growth -- from 21 trillion cubic feet (Tcf) today to 30-35 Tcf in 2015. A sizeable portion of the increase will come from gas-fired electric generation. In the current market, natural gas buyers are no longer limited to buying from one or two pipelines and instead have a wide range of supply options that can be reached through various pipeline transportation options, including capacity release or at market hubs. In addition, an active financial market has developed to allow buyers and sellers of natural gas to hedge against future increases in natural gas prices.

This competition has produced substantial benefits for consumers. Retail gas prices, for example, declined by 42 percent in inflation-adjusted dollars from 1984 to 1994. If gas prices had remained at 1984 levels, consumers would have paid $50-60 billion more for gas in 1995.

Spot wellhead prices for natural gas have roughly doubled over the last year. The wellhead price has averaged over $4.00 per thousand cubic feet since June. (EIA Short-Term Energy Outlook, September 2000.) However, transportation access has made the commodity market liquid and efficient and, despite recent price increases, consumers are still saving money compared to pre-competitive prices. For example, according to one analysis of EIA data, wellhead prices have declined from $4.10/MMBtu in 1983 to $3.13/MMBtu today, in 1998 inflation-adjusted dollars. Moreover, recent wellhead price increases have already prompted a market response by producers to increase the supply of natural gas. The number of natural gas drilling rigs in use, for example, has more than doubled in the past 15 months. Almost certainly, this recent activity will not be sufficient to increase the supply of natural gas in time to mitigate prices this winter. It will, however, help restore a better balance of supply and demand in the future.

I am confident that the fundamental structure of the natural gas market is sound as evidenced by the dramatic increase in drilling activity in response to market signals. Nevertheless, the Commission will be monitoring the gas supply and price situation very closely this winter to assure that competitive pipeline transportation markets continue to work in the public interest.

B. Wholesale Power Markets

Bulk power markets are not as mature as natural gas markets. As noted above, the transmission provisions of EPAct and Order No. 888 have greatly expanded trading opportunities in wholesale markets, and the Commission's ongoing initiative on regional transmission organizations should further address remaining transmission obstacles to competition. And, as sources of generation become more diverse, market power will further diminish in wholesale power markets.

However, circumstances this year demonstrate the still-developing nature of competition in bulk power markets and the need for continuing vigilance by the Commission. Wholesale prices in California, for example, have increased significantly this year, at least for the summer peak months. Prices in some other parts of the country have also been more volatile than in the past. In addition, retail consumers in some areas have increasingly faced the risk of brownouts or blackouts. In mid-June, for example, thousands of consumers in the San Francisco area lost service during a virtually unprecedented heat wave.

The most dramatic price increases this year have been in California. According to San Diego Gas & Electric Company, for example, wholesale market prices in June and July of 1999 rarely exceeded $150/megawatt-hour (MWh), while prices for the same period this year exceeded $250/MWh in 167 hours and $500/MWh in 59 hours.

Recognizing the need for pro-active steps in California as well as other parts of the country, the Commission in late July directed its staff to investigate the conditions in bulk power markets throughout the country. Staff was told to determine any technical or operational factors, regulatory prohibitions or rules (Federal or State), market or behavioral rules, or other factors affecting the competitive pricing of electric energy or the reliability of service, and to report its findings to the Commission by November 1, 2000. I have asked staff to accelerate its investigation as it relates to California and Western markets because the serious events there warrant special attention to California.

In July of this year, San Diego Gas & Electric Company (SDG&E), which was flowing volatile wholesale power costs through to retail ratepayers, filed a complaint with the Commission, seeking immediate imposition of a price cap of $250/MWh for all public utility sellers in the California wholesale markets. On August 23, the Commission ruled on this complaint, instituting formal hearing proceedings under FPA section 206 to investigate the justness and reasonableness of the rates of public utility sellers in California. The Commission will also investigate whether the tariffs, contracts, institutional structures, and bylaws of the Independent System Operator (ISO) and Power Exchange (PX), new market institutions created under California statute, are adversely affecting the efficient operation of competitive wholesale power markets in California and need to be modified. By establishing the hearing proceeding in the August 23 order, the Commission will have the ability under the FPA to order refunds, as appropriate, if it finds that rates for sales by public utilities to the ISO or the PX are unjust or unreasonable. The Commission expects its actions and the measures adopted by the State will moderate price volatility in California markets.

Price volatility has also increased in other parts of the country this summer, particularly the Northeast. In response, the Commission has authorized temporary price caps in both New York and New England, at the same level previously authorized for the adjacent PJM market. These regions are another focal point for the investigation being conducted by the Commission's staff.

I cannot prejudge the results of the Commission Staff's investigative work. There are complex questions of fact involved. As a preliminary matter, however, there appears to be a select list of problem areas that command our closest scrutiny. Clearly, the market conditions that may have otherwise caused aberrant prices in California were exacerbated by the demand growth and high temperatures throughout the West, limiting California's ability to import power from neighboring states. Some of the market-specific issues that appear to be affecting prices include:

- Construction of new generating facilities has not kept pace with rapidly rising electrical demand. According to the California Energy Commission, from 1996 to 1999, demand for electricity in California grew by 5,522 MW, but only 672 MW of new generating facilities were added.

- State-regulated wholesale buyers have been purchasing most of their power in spot markets, which have seen high prices, instead of purchasing power under long-term contracts or hedging their purchases.

- Rates for most buyers are averaged over time (for example, a monthly bill based on total electricity used during the month) so that customers have little incentive to reduce their usage during peak hours when electricity costs are highest.

- There is little competition at the retail level by energy service providers. While many utilities sell power in California's wholesale markets, few compete to sell power directly to retail customers. As a result, those customers are offered few innovative pricing or service options.

- According to some observers, sellers in California have engaged in collusion or other anticompetitive behavior. These allegations are being investigated.

A combination of these or other factors may have contributed to the problems in California this summer. My preliminary view is that the fundamental issue is an overall imbalance of supply and demand. When demand increases and supply does not, as it has in California and other places, prices can be expected to go up. Wholesale market rules and structure may have exacerbated the resulting price increases.

The Commission staff is hard at work on completing its fact-finding investigation. Based on the staff report to the Commission, we will be prepared to take further measures, as appropriate, to address the issues we are discussing today. If we need to fix market rules or market structures within our jurisdiction, we will do so. If market power is being exercised, we will respond accordingly, by revoking or modifying market-based rates or reassessing the basis upon which we grant them. We may order refunds to the extent allowed by the FPA, if refunds are justified by record evidence.

However, the FPA defines the boundaries of the Commission's authority, and leaves responsibility for many helpful measures with California (and other States). For example, the California Energy Commission is responsible for authorizing the construction of new generation and transmission facilities in the State. The State also decides whether State-regulated wholesale buyers are restricted to buying in spot markets or are allowed to choose prudently among the full range of wholesale buying opportunities, including long-term contracts and hedges.

IV. Policy Direction for the Future

A. Commission Agenda

Pursuant to the Government Performance and Results Act, the Commission is preparing a strategic plan for fiscal years 2000-05. Our overall goal is to meet the Nation's needs for energy markets and infrastructure through responsive, flexible regulation. To do so, the Commission must ensure benefits for consumers by establishing a fair, open and efficient regulatory foundation for competition in energy markets. Also, we must foster economic and environmental benefits for the Nation through the approval and oversight of energy projects that are in the public interest.

Our draft strategic plan identifies the key strategies that will allow us to achieve these pro-competitive goals. We will continue to regulate essential monopoly facilities such as electric transmission lines and natural gas pipelines. And we will permit market-based pricing of energy only where market power does not exist or has been mitigated. Where market power persists, the Commission may approve other innovative approaches, such as an index or performance-based rates.

We must continue to nurture competitive market institutions. Foremost on the Commission's agenda for the electric industry is to facilitate and encourage the development of RTOs. The Commission also will continue to encourage the development of e-commerce in the energy industries, particularly the Open Access Same-time Information System (OASIS) for posting services available on the electric transmission grid and electronic bulletin boards (EBBs) for posting services available on the natural gas pipeline grid.

We must continue to monitor and limit the potential anticompetitive effects of corporate consolidation. Mergers of public utilities can create harmful concentrations of market assets that inhibit competition in the market, even though there are also large potential efficiency gains from this kind of reorganization.

Finally, we must facilitate the responsible development of natural gas pipeline capacity to meet the widely-anticipated increases in market demand for natural gas. Most electric generating plants planned for the next five years will use natural gas. Natural gas is a domestically available, clean, and efficient fuel. Continued growth in natural gas consumption requires expanding and enhancing the existing natural gas transportation infrastructure. To respond to this market need, the Commission is committed to timely processing of applications for natural gas pipeline facilities. Recent reports concerning the potential construction of pipeline facilities to transport Alaska North Slope natural gas to consumers presents a significant opportunity to bolster our growing energy economy. As I testified before the Senate Committee on Energy and Natural Resources last week, the Commission is committed to timely resolution of proposed pipeline projects under its jurisdiction, including a reactivated ANGTS (Alaska Natural Gas Transportation System) project.

B. Congressional Action

Congress, too, has a role to play in ensuring that consumers are able to obtain the energy they need at reasonable prices. Most critically, events this summer demonstrate the urgency of enacting electricity legislation to help resolve remaining impediments to competition. Federal restructuring legislation can establish the ground rules that will lead to adequate investment in generation and transmission facilities, and higher levels of reliability which is crucial to the digital economy. I believe Congress should enact legislation that addresses the following elements.

First, Congress should place all electric transmission in the continental United States under the same rules for non-discriminatory open access and comparable service. The Commission's open access rules are not binding on the part of the Nation's transmission system (approximately one-third of all transmission facilities) owned or controlled by entities other than public utilities. Open access over the facilities of public power and other non-public utilities would promote greater competition in wholesale markets, by expanding trading opportunities for wholesale buyers and sellers.

Second, Congress should reinforce the Commission's authority to foster RTOs. RTOs can achieve greater efficiencies in the operation of regional grids and further reduce opportunities for discrimination by transmission providers, and legislation will help ensure that RTOs provide maximum benefits to consumers.

Third, Congress should authorize a means for establishing mandatory reliability rules to protect the operational integrity of the transmission system. I support reliance on a self-regulating organization with appropriate Commission oversight and enforcement. As competition grows throughout the electric industry, reliability legislation is necessary to ensure that the burden and cost of maintaining a reliable electric system is borne fairly by all power providers.

Fourth, Congress should provide the Commission with additional tools to remedy existing market power, which may impair competition to the detriment of consumers. Incumbent utilities or those with strategically placed assets can often control markets unfairly. Currently, the Commission can only address such issues in rate matters or in the context of mergers. The Administration's bill would broaden the Commission's ability to address market power in retail markets, if it were asked to do so by a state that lacks adequate authority to address the problem. The Administration's bill would also give the Commission explicit authority to address market power in wholesale markets by requiring a public utility to file and implement a market power mitigation plan. I believe it would be helpful to close these gaps in the Commission's remedial authorities, especially since the goal of our efforts is to promote market structures that permit light-handed regulation in most respects.

V. Conclusion

The recent price increases in electricity and natural gas markets have renewed concern about the proper role of government in ensuring an adequate supply of energy at reasonable prices. Some argue that energy suppliers are profiting unfairly and ask governmental authorities to limit or even retrieve excessive profits. Sustained and abnormally high energy prices impose an unfair penalty on consumers and the economy. Yet, I believe that effective competition remains a better tool for providing a discipline on prices, encouraging new investment, developing new services and innovation, and serving consumers, than is traditional command and control regulation of monopolies. If competition is not working effectively, however, we must learn why and take steps to ensure it works for all American consumers. Until markets are restructured and working effectively, we must carefully manage the transition to ensure that competitive market initiatives are not summarily reversed before their benefits are fully realized by the public.

Thank you.

Key Areas of FERC Regulatory Responsibility

Type of Regulation	Investor-owned Electric Power	Interstate Natural Gas Pipelines	Interstate Oil Pipelines	Nonfederal Hydropower Projects
Regulation of Markets and Rates, Terms, and Conditions of Energy Services				
- Transmission	Yes	Yes	Yes	N/A
- Sales for Resale	Yes	Yes	No	N/A
- Corporate	Yes	No	No	N/A
Authorization and Monitoring of Energy Facilities				
- Siting	No	Yes. The Commission issues certificates for construction of pipelines and related facilities.	No	Yes. The Commission issues licenses, exemptions, and license amendments.
- Environmental	No, except for programmatic EISs for some major actions.	Yes, NEPA review and interagency consultation for pipelines to be certificated.	No	Yes, NEPA review and interagency consultation for the above authorizations.
- Safety	No	No, except as part of initial certification–incorporation of DOT standards.	No	Yes, dam and public safety.

Related Responsibilities of Other Key Agencies

States	Retail sales, local distribution, siting for transmission lines and generation facilities,unbundled retail transmission	Retail sales, local distribution, intrastate transportation, natural gas production and gathering	Siting	Projects that do not affect navigable waters, interstate commerce, or Federal lands or dams
Other Federal Agencies	*DOE:* Power Marketing Administrations *EPA:* air quality *NRC:* nuclear power licenses *USDA:* electric cooperatives	*DOT:* safety *DOI:* siting in offshore waters, federal lands, national parks; endangered species *USFS:* siting in national forests *COE:* water body crossings *Advisory Council on Historic Preservation:* cultural resources *EPA:* PCBs *National Marine Fisheries Service:* offshore fisheries	*DOT:* safety	*DOI:* federal lands, national parks, fish and wildlife, endangered species *USFS:* national forests *Advisory Council on Historic Preservation:* cultural resources *National Marine Fisheries Service:*Fisheries resources